





A Balanced Approach

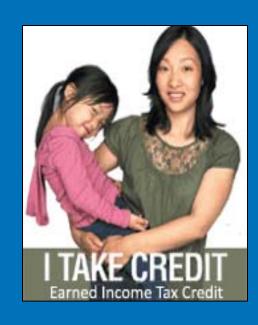
- Increase program participation
- Reduce erroneous payments



EITC Facts

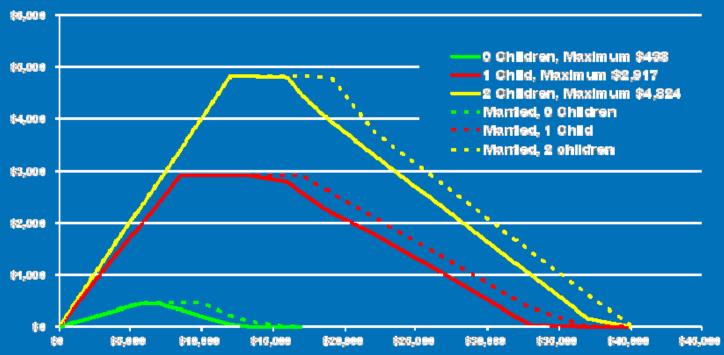


- For Tax Year 2006, over \$22M returns were credited with over \$43B in EITC
- The number of individuals claiming EITC is high, and erroneous payments are also high
 - Participation is estimated at 75 to 80%
 - 23 to 28% error rate according to current estimates



For 2008, the Maximum EITC is \$4,824





- ✓ Credit phases out as income increases
- ✓ Claiming children raises the limit on income eligibility and increases the value of the credit
- ✓ If married, income eligibility increases up to \$3,000



EITC Environment

70% of EITC Taxpayers Use Paid Preparers

Over 80% of EITC
Returns Filed
Electronically Qualifying Children,

Filing Status &
Income Reporting
Errors =
Main Areas of
Noncomplianc

\$10 – 12B in Erroneous Payments

Why Talk About Due Diligence?

• Preparer community's feedback regarding due diligence guidance

GAO and external audit results

 Recent criminal cases and injunctions

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A Balanced Approach to Addressing Due Diligence

Outreach and Education:

- Partnership with software developers to make enhancements
- Developing EITC training modules
- New IRS due diligence regulations

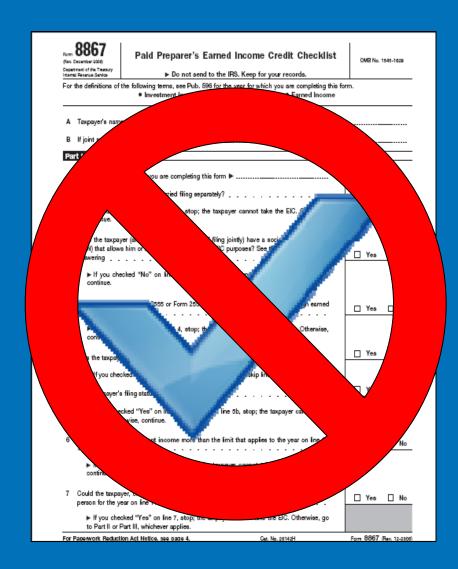


A Balanced Approach to Addressing Due Diligence

Compliance:

- Due Diligence Visits (DDV) / Audit Program
- E-file Sanctions
- Injunction Actions Barring
 Preparers from Return Preparation
- Criminal Prosecutions

EITC Due Diligence Is NOT Just A Checkmark On A Form!



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Internal Revenue Code § 6695(g) – Due Diligence Requirements

Checklist Completion



Credit Computation



(1)

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Knowledge of Correct Taxpayer Information



Record Retention



(3

(4)

Requirement #1-Form 8867, Paid Preparer's Earned Income Credit Checklist (or its equivalent)

_	om 8607 (Rev. 12-2006) Dec III Toxpovers Without a Qualifying Child		Page 3
Par	rt IV Due Diligence Requirements		
20	Did you complete Form 8887 based on information provided by the taxpayer or reasonably obtained by you?	Yes	□ No
21	Did you complete the EIC worksheet found in the Form 1040, 1040A, or 1040EZ instructions (or your own worksheet that provides the same information as the 1040, 1040A, or 1040EZ worksheet)?	☐ Yes	□ No
22	Did you comply with the knowledge requirements? (To comply with the knowledge requirements, you must not know or have reason to know that any information used to determine the taxpayer's eligibility for, and the amount of, the EIC is incorrect. You may not ignore the implications of information furnished to or known by you, and you must make reasonable inquiries if the information furnished appears to be incorrect, inconsistent, or incomplete.)	☐ Yes	□ No
23	 Did you keep the following records? Form 8867 (or your own form or files), The EIC worksheet(s) or your own worksheet(s), and A record of how, when, and from whom the information used to prepare the form and worksheet(s) was obtained If you checked "Yes" on lines 20, 21, 22, and 23, and keep the records described on line 23 for 3 years (see instructions), you have compiled with all the due diligence requirements. If you checked "No" on line 20, 21, 22, or 23, you have not compiled with all the due 	☐ Yes	□ No
	diligence requirements and may have to pay a \$100 penalty for each failure to comply.		
-	► If you checked "No" on line 15, stop; the taxpayer cannot take the EIC, if you checked "Yes" on line 15, the taxpayer can take the EIC,		

For Paper

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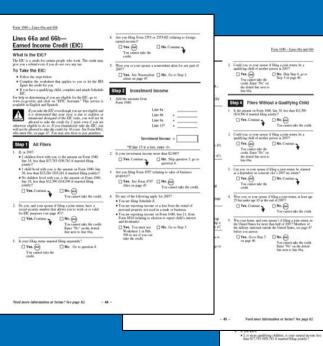
► If you checked "No" on line 15, stop; the taxpayer cannot take the EIC, if you checked "ves" on line 15, the taxpayer can take the EIC. Complete 8 chedule EIC and attach it to the taxpayer's return. If there are two qualifying children with valid 88Ns, list them on 8 chedule EIC in the same order as they are listed here. If the taxpayer's EIC was reduced or disallowed for a year after 1996, see Pulb. 596 to see if Form 8882 must be filled. Go to line 20.

67 (Rev. 12-2006)

Form 8867 /Rev. 12-2006

Requirement #2 – Credit Computation





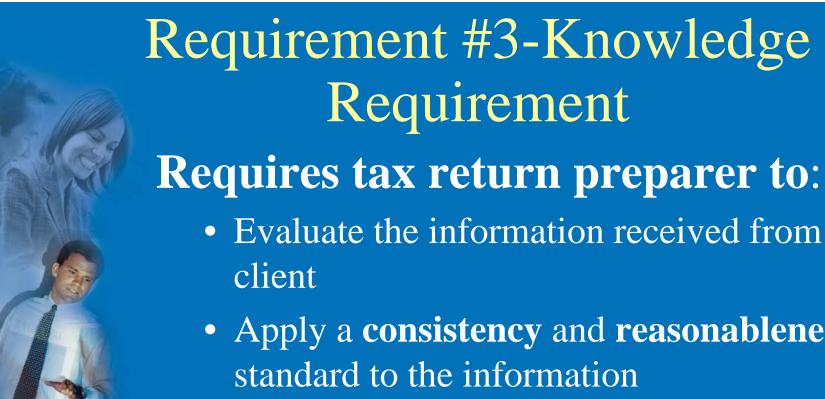
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- - Evaluate the information received from the
 - Apply a consistency and reasonableness
 - Ask additional questions when applicable
 - Make reasonable inquiries if the information appears to be incorrect, inconsistent, or incomplete
 - Document additional inquiries and the client's response

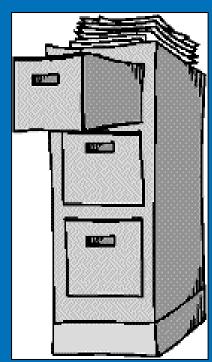
Requirement #4 - Recordkeeping

Tax Return Preparers Must Keep:

- Form 8867 or its equivalent
- EIC worksheet or its equivalent

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 Record of how information was furnished and who furnished the information used to prepare EITC claim



The Knowledge Requirement is Addressed in New Proposed Regs. 1.6695-2

- A tax return preparer must make reasonable inquiries if a reasonable and well-informed tax return preparer knowledgeable in the law would conclude that the information furnished to the tax return preparer appears to be incorrect, inconsistent, or incomplete.
- The tax return preparer must also contemporaneously document what additional inquiries were made and the client responses to these inquiries.

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Not as Easy as it Looks

I TAKE CREDIT

Incorrect Social Security Numbers

- Must have earned income
- 2 Must have a valid Social Security number
- 3 Cannot file as married filing separately
- 4 Generally cannot be a nonresident alien
- 5 Cannot be a qualifying child of another person
- 6 Cannot be filing Form 2555 or Form 2555-EZ
- 7 Investment income amount is limited





Qualifying Children

RELATIONSHIP AGE

Is a son or daughte find an adopted child or At the end of the filing year was:

Lated child, the terimon and platfied the last the size of younger than 24 and a full-time student, or proceed and a full-time student, or any age if permanently and totally disabled at a prother, sister, stepprother, stepsister or a

any timé during the vear descendant of any of them

Example Scene 1

• A client wishing to have her taxes prepared informs you:

She is separated from her spouse

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Her child, who is 7 years old,
 lives with her and she wants to
 claim EITC



Does This Scenario Prompt You to Ask More Questions?

You ask...

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- Are you still married?
- When did you separate from your husband?
- Did you move to separate homes, and if so, when?
- How long during the year did your child live with you?
- Did you live with anyone else?

She says...

- Yes, I'm still married but separated
- January of last year
- Yes, in January of last year
- My child lived with me every day except every other weekend and two weeks in the summer
- No, I didn't live with anyone



You Say...

• It looks like you may qualify for EITC. I'll go through the rest of the questions and do the computations to make sure.

Fare 8867 (Fine December 2006) December of the Triance	Paid Preparer's Earned Income Credit Checklist	OMB No. 1545-1529							
Internal Revenue Service	▶ Do not send to the IR8. Keep for your records.					Page 2			
For the definitions of	the following terms, see Pub. 596 for the year for which you are completing this • Investment income • Qualifying Child • Earned Income	form.	lid	Chi	ld 1	Child 2			
	o b		er,	☐ Yes	□ No	Yes No			Pay
Port All Tax	pavers			□ Yes	□ No	☐ Yes ☐ No	use if fling jointly, in the		
	for which you are completing this form		ne	☐ Yes	□ No	☐ Yes ☐ No	d active duty outside the y period. See Pub. 596.)	☐ Yes	□и
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(88N) that allow	er (and the taxpayer's spouse if filing jointly) have a social security number shim or her to work or is valid for BC purposes? See the instructions before	☐ Yes ☐ No	n) ot				ne EIC. Otherwise,		
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	Ning Form 2555 or Form 2555-EZ (relating to the exclusion of foreign earned	☐ Yes ☐ No					the EIC. Otherwise,		
► If you cha continue.	icked "Yes" on line 4, step; the taxpayer cannot take the EIC. Otherwise,		re	☐ Yes ☐ Don't	□ No know	Yes No	less than the limit that	☐ Yes	_ N
	ar a nonresident alien for any part of the year on line 17	Yes No	to ny er				if you checked "Yes"		
	cked "Yes" on line 5a, go to line 5b. Otherwise, skip line 5b and go to line 6. If ling status married filing jointly?	Yes No	14				duced or disallowed for ed. Go to line 20.		
► If you che	cked "Yes" on line 5a and "No" on line 5b, stop; the taxpayer cannot take energy continue.		ig te io				er or reasonably obtained	☐ Yes	_ N
	s investment income more than the limit that applies to the year on line 1? If the limit	Yes No		☐ Yes	□ No	Yes No	60EZ instructions (or your 1040EZ worksheet)?	□ Yes	_ N
► If you che continue.	cked "Yes" on line 6, stop; the taxpayer cannot take the EC. Otherwise,		ot 8				wiedge requirements, you e the taxpayer's eligibility		
	yer, or the taxpayer's spouse if fling jointly, be a qualifying child of another ear on line 1?	Yes No	ee ab.				is of information furnished tion furnished appears to	☐ Yes	Пи
► If you che to Part II or	cked "Yes" on line 7, stop; the taxpayer cannot take the EIC. Otherwise, go Part III, whichever applies.		-			☐ Yes ☐ No			
For Paperwork Reduct	Ion Act Notice, see page 4. Car. No. 251424	Form 8867 (Park. 12-2005)					he form and worksheet(s)		
	Form 8862 must be filed. Go to	line 90					ile ioini alid worksileel(s)	☐ Yes	□ N
	Puriti code must be filed. Go to	me 20.				Form 8867 (Rev. 12-2009)	cords described on line diligence requirements.		



Scene 1---Take 2

You ask...

- Are you still married?
- When did you separate from your husband?
- When did you stop living in the same home?
- Are you going to file a tax return with your husband?

She says...

- Yes, I'm still married but separated
- November of last year
- I moved out when we separated in November
- No, I want my own refund

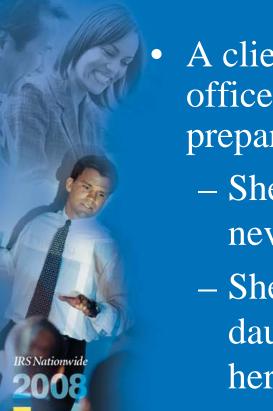
Does She Qualify for EITC?



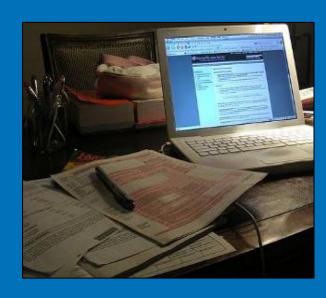


- No
- Her filing status is:
 - Married Filing Separate





- A client walks into your office to have her taxes prepared and informs you:
 - She is 18 years old and never been married
 - She has a 2 year old daughter and lives with her parents
 - She has earnings of \$3,000 from a part-time job
 - She wants to claim EITC





Scene 2 -- Take 1

You ask...

- When did you move in with your parents?
- Did your daughter live with you all year?

She says...

November last year

 No, she lived with my parents



Does She Qualify for EITC?



- No
- Why?
 - The child had to live with her for more than half the year, so she doesn't meet the Residency requirement



Scene 2 -- Take 2

You ask...

• When did you move in with your parents?

She says...

• I have always lived with my parents



You Say...

• You don't qualify for EITC because you are the qualifying child of your parents



Scene 2 -- Take 3

You ask...

• When did you move in with your parents?

 Did your child live with you from January to November?

She says...

- I moved home in November last year.
 It was too hard raising my daughter on my own
- Yes



You Say...

• It looks like you may qualify for EITC. I'll go through the rest of the questions and do the computations to make sure.

Form 000 f Paid Preparer's Earned Income Credit Department of the Themps ▶ Do not send to the IRS. Keep for your rec	OMB No. 1546-1629								
For the definitions of the following terms, see Pub. 596 for the year for which you as		ld.	Child	-	Chi	Page 2 ld 2			
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B If joint return, spouse's name ▶		- I I.		l			use if filing jointly, in the		
All Taxpayere 1 Year after 2005 for which you are completing this form >		L -		□ No	☐ Yes	□ No	d active duty outside the typeriod. See Pub. 596.)	☐ Yes	□м
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4 Is the texpayer filing Form 2555 or Form 2555-EZ (relating to the exclusion of income)?							the EIC. Otherwise,		
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the ElC. Otherwise, continue. 6 is the taxpayer's investment income more than the limit that applies to the y	aer on line 12	la la	□ Yes [- Mar	- No.	er or reasonably obtained	☐ Yes	□ N
See Pub. 590 for the limit		ic ot	_ TeS [No.	☐ Yes	□ No	i0EZ instructions (or your i040EZ worksheet)?	☐ Yes	□ N
► If you checked "Yes" on line 6, stop; the taxpayer cannot take the El continue.	C. Otherwise,	18					Medge requirements, you e the taxpayer's eligibility		
7 Could the taxpayer, or the taxpayer's spouse if filing jointly, be a qualifying of person for the year on line 1?		es ab.					is of information furnished tion furnished appears to	☐ Yes	□ N
► If you checked "Yes" on line 7, stop; the texpayer cannot take the EIC, to Part II or Part III, whichever applies.		[·			☐ Yes	□ No			
For Paperwork Reduction Act Notice, see page 4. Cer. No. 2614	H Form 8867 (Faw. 12-2005)						he form and worksheet(s)		
Form 8962 mu	at be filed. Go to line 20.	┙ ┃						☐ Yes	□ N
Politi dode inc					Form 8867	(Flev. 12-2000)	cords described on line diligence requirements.		



Example Scene 3

- The next client informs you:
 - He is 22 years old
 - He has two sons, ages 10 and 11
 - He wants to claim EITC





Scene 3 -- Take 1

You ask...

- What is your relationship to these children?
- Were you ever married to the mother?
- Were the children placed in your home for adoption or as foster children by a court or authorized agency?

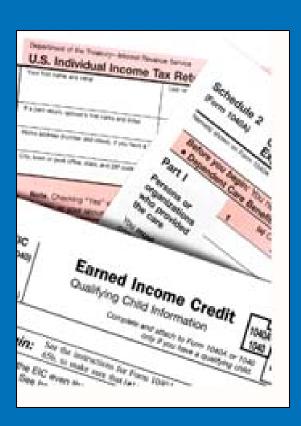
He says...

- They're my girlfriend's sons but I paid all the bills
- No
- No



You Say...

• Sorry, you don't qualify for EITC because your girlfriend's sons do not meet one of the defined EITC relationships.





Scene 3 -- Take 2

You ask...

- What is your relationship to these children?
- Were you ever married to the mother?
- Did the mother live with you last year?
- When did she move in?
- How long did the children live with you?
- The IRS may ask for documentation, do you have any proof the children lived with you, such as school or doctor records?

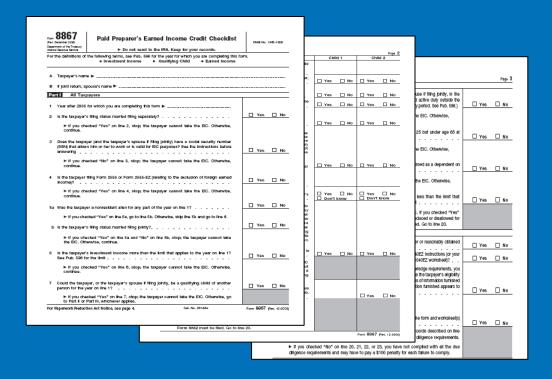
He says...

- They're my girlfriend's sons but I paid all the bills
- Yes, but we divorced two years ago
- Yes, we got back together
- Late summer, August
- All year
- Yeah, both the doctor and school have my address, I pay all the bills



You Say...

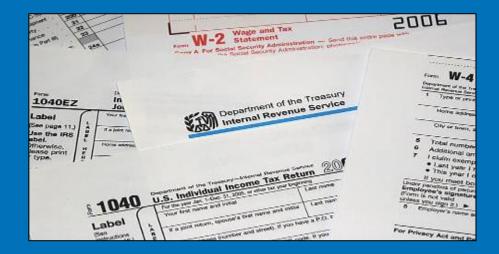
• You may qualify for EITC, I need to ask you some additional questions





Example Scene 4

- A client tells you:
 - She is head of household and has 2
 children ages 13 and 14
 - She was self-employed cleaning houses, earned \$12,000, and had no expenses





Scene 4 -- Take 1

You ask...

- Are you or were you ever married?
- Did you live with anyone else besides your children?
- Do you have records of the amount of money you received from house cleaning?
- How much did you charge to clean a house?
- How many houses did you clean?
- Who provided the cleaning supplies?

She says...

- No
- No
- No, but I know what I earned
- 60 dollars per house
- I don't know. It wasn't always the same houses
- The home owner provided everything



Would You Prepare Her Tax Return?

- Probably not
 - You need to tell her that IRS requires a written record of amounts earnings and expenses—copies of receipts, invoices, etc.
- Unless,
 - She is able to reasonably reconstruct her income and expenses





You ask...

- Are you or were you ever married?
- Did you live with anyone else besides your children?
- Do you have records of the amount of money you received from house cleaning?
- Did you need to buy any supplies?
- Do you have receipts for the expenses?

She says...

- No
- No

- Yeah, I make entries on my calendar each week and I have copies of the receipts I gave out
- Yes, I purchased cleaning products, sponges, dust cloths and a vacuum
- Yes



Would You Prepare Her Tax Return?

- Probably yes
 - She has invoices and receipts
 - But, you need to look a the reasonableness of her income and expenses



Example Scene 5

- You completed a client's tax return last year:
 - Last year, she filed single and claimed her child for the EITC
 - This year, she asks to claim 2 children for the EITC





Scene 5

You ask...

- Last year you claimed one child, what changed?
- Is the child related to you?
- Did the child live with you?

She says...

- My friend has 3 children and only needs 2 for the EITC, so she said I could use her child
- No
- No



You Say...

- Your second child does not qualify because the child does not meet the:
 - Relationship test
 - Residency test
- Now, I have to ask you additional questions to verify your first child still qualifies you for EITC

How Does the IRS Ensure Due Diligence Compliance?

Due Diligence Visits



EITC Due Diligence Visits





- Due diligence audits conducted annually
- Selection based on standard criteria applied to all EITC returns
- Due diligence visits are conducted between October and March

Key Facts About EITC Due Diligence Visit Program

- Examination to check paid preparer compliance with all 4 requirements of IRC §6695(g)
- General examination guidelines apply
- IRS requests appointments scheduled within 15 days of contact

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- IRS will interview both the employee and employer
- Penalties are \$100 for each return where due diligence requirements are not met



What You Can Expect if You are Selected for an EITC Due Diligence Visit



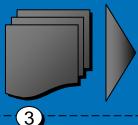




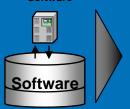
Preparer Interviews conducted



Examiner Reviews Returns



Examiner Reviews
Software



Examiner Makes Penalty
Determination



- Appointment set by phone or letters
- ▶ Both employee and employer (if applicable) are contacted
- Examiner interviews preparer and employer
- Examiner reviews 25 returns
- Sample expanded if non-compliance with due diligence requirements is noted
- ▶ Data intake questionnaire reviewed
- Form 8867 questionnaire reviewed
- ► EIC Computation Worksheet reviewed
- Presets and overrides reviewed

- Examiner determines if preparer has complied with IRC 6695(g)
- ▶ If penalties are warranted, examiner determines whether to assess penalties against the employer or employee preparer

Other Key Facts About EITC Due Diligence Visit Program

- If penalties are proposed you may
 - Agree and pay the penalties
 - Request an informal managerial hearing to discuss the issues
 - Choose to disagree with the penalties and receive
 30-day letter
 - File a timely protest to request an Appeals hearing before penalties are assessed
- File Form 6118, Claim for Refund of Income Tax Return Preparer Penalties, after penalties are assessed and within 3 years from the date you pay the penalties



IRC §6695(g) Penalty Exceptions



- Preparer's normal office procedures are reasonably designed and routinely followed to ensure compliance
- Failure to meet the requirements on a return is isolated and inadvertent
- Key questions to determine whether exception may apply
 - Are preparers trained in EITC Due Diligence requirements?
 - Are there written instructions to employees on how to comply?
 - Is there a quality control process?

In 2007, 90% of Due Diligence Penalties Were Assessed Due to Failure to Comply With the Knowledge Requirement

Most problems occur when:

Filing status may be unclear (e.g. separation)

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Qualifying child eligibility issues are apparent

Information appears inconsistent or unlikely



Summary

- EITC Due Diligence is not just a checkmark on a form
- Don't rely on software alone
- Know the EITC tax law
- Apply sound judgment and common sense to information provided
- Ask questions as needed and document the answers

EITC Resources



- On-Line Tools at irs.gov
 - EITC Website:www.irs.gov/eitc
 - Tax Practitioner Toolkit: www.eitcfortaxpreparers.com
 - EITC Assistant
 - Publications, Forms and Worksheets, including
 - Publication 596, Earned Income Credit
 - Form 8867, Paid
 Preparer's Earned Income
 Credit Checklist

